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RUEHML/AMEMBASSY MANILA 0351  
RUEHJA/AMEMBASSY JAKARTA 4257  
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STATE FOR EAP/RSP/TC, EAP/EP  
USTR FOR KATZ AND STRATFORD  
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TREASURY FOR OASIA/TTYANG AND HAARSAGER  
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF  
GOVERNORS, SAN FRANCISCO FRB/TERESA CURRAN, AND NEW YORK FRB MARI  
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SUBJECT: Taipei Economic Brief for January 2008

11. (U) Summary. Here are the highlights of January 2008 economic events in Taiwan. Taiwan's economy outperformed expectations in 2007, with capital outflow partly offsetting inflationary pressure.... Taiwan's 2008 economic outlook less optimistic.... Initial public offerings in 2007 set a three-year high.... Four state-owned banks morph into Taiwan's largest financial holding firm.... Mini-links Ferry boat passengers posted double-digit growth.... Tax incentives adopted for foreign expats.... High-speed rail hurts airlines, busses and slow trains.... Taiwan goes green with new Greenhouse Emission Management Office subsidies for cleaner cars.... Asahi Glass to build polysilicon plant for solar power industry.... Think Yachts - Think Taiwan... No, Taiwan has no plans for a sovereign wealth fund. END SUMMARY.

Taiwan's 2007 Economic Performance - Underestimated?

12. Taiwan's economy outperformed expectations in the second half of 2007, and final figures for Taiwan's 2007 real GDP growth are likely to exceed the current official preliminary figure of 5.46%. In 2007, export growth accelerated throughout the year, reaching 15% in the fourth quarter, well ahead of earlier forecasts. Manufacturing growth also accelerated from 1% in Q1 to 14% in Q4. Electronic and electrical parts/components which account for 40% of merchandise exports posted 21% growth in 2007, with the Q4 y-o-y growth exceeding 30%. Chemicals also reported a sharp increase in production growth from 3% in Q1 to 18.5% in Q4. Accelerated growth in wholesale/retail sales as well as imports of consumer goods fed the expansion of private consumption. Private investment also gained momentum as imports of capital goods grew 3% in 2007, after virtually no growth in 2006. Taiwan's Unemployment in 2007 leveled off at just under 4%.

Capital Outflow Partly Offsets Inflationary Pressure

13. Typhoons and higher import costs for energy and commodities

pushed Taiwan's year-on-year inflation rate to a 13-year high of 5.3% in October. The inflation rate subsequently declined to 3.3% in December after the typhoon season passed. The import-driven inflationary pressure has been partly offset by net capital outflows which reduced M1B money supply growth in December 2007 to 1.07%, a seven year low. The M2 money supply growth at 1.36% was the lowest since 1982. (Note: M1B refers to money circulating in the economy plus checking account deposits, and M2 refers to M1B plus savings deposits. End Note.)

#### 2008 Outlook Less Rosy

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14. In 2008, exports are likely to expand in Q1 by double-digit rates as export orders which grew by 18% y-o-y in Q4 of 2007 are likely to be produced and delivered in Q1 of 2008. Later in the year, however, an anticipated economic slowdown in the U.S. and other developed economies will likely translate into a slowdown in Taiwan's export expansion and its economic growth. Official forecasts call for 2008 real GDP growth of 4.5%. This is in the range of most private forecasts which fall between 4.0-4.5%. Deutsche Bank and Standard Chartered Bank are more pessimistic, forecasting only 3.6% and 2.8%, respectively.

#### Initial Public Offerings (IPOs) Set 3-year High

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15. In 2007 there were 70 IPOs in Taiwan, a three-year high. The IPOs include 30 on the Taiwan Stock Exchange (TSE) and 40 on the Over-the-counter market (OTC). The Financial Supervisory Commission set targets of 85 IPO's in 2008 and 95 in 2009. To achieve the goals, in January 2008, the FSC relaxed requirements for firms to list on the island's stock markets. Minimum capital and market value requirements were eliminated for OTC listings. For the TSE,

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the minimum capital requirement was lowered from NT\$600 million to NT\$300 million (US\$9.2 million).

#### Four State Banks Merge

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16. Four state-owned banks - Bank of Taiwan, Land Bank of Taiwan, Central Trust of China, and Export-Import Bank - were merged into Taiwan Financial Holdings, a new 100% government-owned financial holding company on January 1. With assets totaling NT\$5.12 trillion (US\$157.5 billion), it is the largest financial institution in Taiwan and the 89th largest in the world. Its assets account for 18% of the banking sector's total assets. The merger has reduced the number of state-controlled banks to seven, although these firms still dominate the banking sector with a market share of 51% in terms of assets and 56% in terms of loans.

#### Mini Three Links

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17. The number of ferry boat passengers between Taiwan's Kinmen/Matsu and the PRC's Xiamen, Chuanzhou and Fuzhou grew 16% to a new high of 391,930 in 2007. This equals ten percent of total passengers between Taiwan and Hong Kong/Macao. The number of Taiwan passengers posted a growth of 15% to 338,618 which accounted for 86% of total cross-Strait passengers by ferry boat. The number of Chinese passengers surged 27% to 53,322. The number of port calls by ferry boats in 2007 increased 21% to 5,391 of which 40% was made by PRC-based ferry boats.

#### Tax Incentives for Employment of Foreign Experts

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18. Effective January 2008, the Ministry of Finance (MOF) adopted new tax incentives for certain foreign expatriates in Taiwan. Travel expenses for expatriates and their families, home leave, moving costs, utility bills, house rental and repair, and education for children will be excluded from income. For employers, the expenditures can be treated as operating expenses and deducted from the taxable income.

#### High-speed Rail Cheers; Bus, Train, Plane Tears

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19. Taiwan's high-speed railway (HSR), which began commercial operation in January 2007, has caused a drastic drop in air

passengers. Revenue from domestic flights along Taiwan's populated west coast plunged 60% in 2007. Unable to compete with HSR, domestic airlines, have already suspended flights from Taipei to Taichung, Chiayi and Pingtung. Far East Transport (or FAT) plans to suspend Taipei - Tainan flights in March. Adding insult to injury, the Taiwan post office has started using HSR to transport express mail. Busses and "normal" trains are also feeling the competitive pressure. The number of long-distance non-high-speed railway passengers declined 30%, and the number of long-distance bus passengers dropped 20%. The Taiwan Railway Administration will reduce non-high speed rail tickets to attract passengers. Expect more pressure in 2008 as the number of high-speed rail passengers is expected to double.

#### Exposure to Sub-prime Mortgage Products

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¶10. Banks and other financial service firms continue to report exposure to collateralized debt obligations (CDOs) and structured investment vehicles (SIVs) which may be linked to the U.S. sub-prime mortgage crisis. According to the Financial Supervisory Commission (FSC) as of December 2007 exposure to CDOs increased from NT\$75 billion (US\$2.3 billion) in August to NT\$81.94 billion (US\$2.5 billion). The updated exposure included NT\$58.59 billion (US\$1.8 billion) for 21 Taiwan banks and NT\$39.5 billion (US\$1.2 billion) for 12 insurance companies, and NT\$4.6 billion (US\$141 million) for

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holders of five mutual funds. In addition, exposure to structured investment vehicles (SIVs) totaled NT\$21.38 billion (US\$658 million), including NT\$20.52 billion (US\$631 million) for banks and NT\$1.23 billion (US\$38 million) for insurance firms. These numbers do not represent losses, but overall holdings of CDOs and SIVs. Separately, as of December 2007, estimated losses in the CDO and SIV asset categories were NT\$23.7 billion (US\$729 million), including NT\$22 billion (US\$677 million) for banks and NT\$6.87 billion (US\$211 million) for insurance companies. This has eroded 10% of Taiwan financial institutions' profits in 2007 which remained about NT\$150 billion (US\$4.6 billion).

#### Greenhouse Gas Reduction Management Office

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¶11. On January 10, Taiwan's Environmental Protection Administration (EPA) inaugurated the Greenhouse Gas Reduction Management Office. Fifty-four manufacturing firms in the electricity, iron & steel, and petrochemical industries have voluntarily reported their GHG emissions. The EPA expected the number of reporting firms will reach 100 within one year and 300 over the next three years.

#### EPA Subsidizes Cleaner Cars

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¶12. Taiwan's EPA adopted a subsidy program to promote cleaner cars. EPA will reduce the commodity tax by NT\$25,000 (US\$769) for the purchase of a hybrid car or a car fueled by liquid petroleum gas (LPG). In addition, the EPA will provide buyers a separate subsidy of NT\$25,000 (US\$769). The EPA will also subsidize the cost of LPG fuel by NT\$2 (about 6 US cents) per liter.

#### Asahi Glass to Build Solar-grade Polysilicon Plant

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¶13. Asahi Glass, whose major shareholder is California-based Silicon Research Inc (SRI), will build a solar-grade polysilicon plant in central Taiwan. Polysilicon is a key material for photovoltaics. The plant is expected to begin commercial operation late this year. In the next three-to-five years, the new plant's annual production will increase to 10,000 tons of solar-grade polysilicon which will be sufficient to meet demand by a growing number of solar photovoltaic (PV) manufactures in Taiwan. According to the Industrial Development Bureau, 24 new companies entered Taiwan's solar PV industry in 2007.

#### Taiwan 5th in Yacht Building

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¶14. The US yachting magazine "ShowBoats International" ranked Taiwan the fifth largest in yacht builder in the world. In 2007 Taiwan builders received orders for 71 super yachts, those at least 80 feet long. The total number of feet on order with Taiwanese

builders in 2007 was 6,867 feet, a 60% increase over 2006. According to Taiwan's Industrial Development Bureau, Taiwan yacht builders hold 6% of the global market, behind Italy's 43.6%, the United States' 11.7%, the Netherlands' 9.2%, and Germany's 8%. According to Showboats' latest rankings, three Taiwan companies were ranked among global top twenty: Horizon (12th), OceanAlexander (16th), and KhaShing (17th).

Not a Sovereign Wealth Fund

¶15. Local media recently reported that Taiwan intended to set up a sovereign wealth fund. The fund in question, named Taiwan International Development Corporation (TIDC), will have NT\$2 billion (US\$61.5 million) in capital, with Taiwan authorities contributing 40% and the remaining 60% from the private sector. The Ministry of Economic Affairs clarified that TIDC is not a sovereign wealth fund, and that the government's contribution to TIDC does not come from Taiwan's foreign exchange (FX) reserves. Private shareholders

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dominate TDIC, which is designed to seek construction opportunities in the Persian Gulf Region (a market which is expected to reach US\$6.6 trillion). The Central Bank has repeatedly stated that it may not use Taiwan's FX reserves to serve any official investment purpose. The Central Bank said capital funds brought into Taiwan by foreign portfolio investors constitute about half of Taiwan's FX reserves, and that the bank has to maintain sufficient liquidity to meet any sudden demand for capital by these foreign portfolio investors.

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